

Business Tax Administrative Rule 7.07 – 1050

7.07 – 1050 Partnership Basis Adjustments

Per Metro Code 7.07.070, Business Income Tax is assessed at the entity level. Partnerships that acquire assets have basis in the assets (partnership basis), while the partners have basis in their individual interest in the partnership (partner basis). Sales of partnership interests can create disparity between partnership and transferee partner basis. Distributions of partnership assets can also create basis disparities. IRC Section 754 allows some remedy for these disparities at the partnership level by allowing the partnership to increase its basis and related depreciation. However, this allowance is allocated (through Schedule K and K-1) to only the involved partners. While the form of the Section 754 election is a partnership transaction, in substance it is deemed to be a partner-level transaction because it relates directly to the calculation of partners' basis.

A deduction for the step up in basis for partnership assets related to an Internal Revenue Code (IRC) Section 754 election (which allows IRC Section 734 and 743 adjustments) is not allowed for the Business Income Tax. The stepped-up basis applies to the transferee individual partners(s) only and is reflected on the partner's Schedule K-1, regardless of the fact that it may have also been reported on Schedule K of the partnership's return. IRS Form 1065 instructions for tax year 2017 (subject to change) state the adjustments must be on an attached statement to Schedule K-1 using the codes for Other Income or Other Deductions. For purposes of this rule, partnerships include any tax entity that directly reports Section 754 adjustments.

Example 1:

Individuals A, B, and C form Partnership Z as equal partners (each owning 33.3%). The partnership purchases a building for \$600,000. Over the next five years, the partnership has depreciated the building by \$60,000 and now has a remaining basis of \$540,000. This depreciation deduction was used to reduce the Metro taxable income of Partnership Z. Each of the three partners now has a basis of \$180,000.

Individual A then sells their interest in Partnership Z to Individual D for \$500,000. The gain on the sale of the partnership interest recognized by Individual A of \$320,000 would generally not be subject to the Metro Business Income Tax as it is the investment income of an individual. It would be subject to the Personal Income Tax. Individual D now has a \$500,000 depreciable basis in the building through their partnership interest. If Partnership Z makes an IRC Section 754 election, Individual D may take an additional depreciation deduction on their federal tax return based on the increase in the "transferee partner basis" of Individual D's purchased asset. However, this deduction is not allowed on the Metro tax return of Partnership Z.

Example 2:

Corporation A and B form Partnership X as equal partners (each owning 50%). Corporation C bought its interest (50%) in Partnership X solely from Corporation A. Corporation C does business in the Metro district in addition to its ownership percentage of Partnership X. Corporation C sells its interest in Partnership X three years later. Corporation C can include its stepped-up basis in determining the reportable gain from the sale of the interest in Partnership X when determining Metro taxable income because Partnership X did not get to claim any of the additional depreciation from Corporation C's stepped up basis.

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Date

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